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IN THE

Supreme Court of the United States

October Term, 1942.

No. 880.

THE AETNA CASUALTY AND SURETY COMPANY,
Petitioner,

v.

FIRST CAMDEN NATIONAL BANK AND TRUST COMPANY,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOSEPH W. HENDERSON,
Attorney for Petitioner.

GEORGE M. BRODHEAD, JR.,
Of Counsel.

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TABLE OF CONTENTS OF PETITION.

	Page
Summary and Statement of Matter Involved.....	1
Jurisdiction	7
Opinions	8
Questions Presented	8
Reasons for Granting the Petition	9

CASES CITED IN PETITION.

	Page
Board of County Commissioners of the County of Jackson, Kansas v. United States, 308 U. S. 343 (1939)	9
Deitrick, Receiver v. Greaney, 309 U. S. 190 (1940)	9
D'Oench, Duhme & Co., Inc. v. Federal Deposit Insurance Corporation, 315 U. S. 447 (1942)	9
R. P. Farnsworth & Co., Inc. v. Electrical Supply Co., 112 F. (2d) 150 (C. C. A. 5th, 1940)	10
Grover v. Board of Education of Township of Franklin, 102 N. J. E. 415, 141 Atl. 81 (1928) affd. in 104 N. J. E. 197, 144 Atl. 918 (1929)	6
Henningsen v. United States Fidelity & Guaranty Co., 208 U. S. 404 (1908)	10
Martin v. National Surety Co., 300 U. S. 588 (1937)	10
Morley Construction Co. v. Maryland Casualty Co., 300 U. S. 185 (1937)	10
O'Brien v. Western Union Telegraph Co., 113 F. (2d) 539 (C. C. A. 1st, 1940)	10
Prairie State Bank v. United States, 164 U. S. 227 (1896)	10
Royal Indemnity Co. v. United States, 313 U. S. 289 (1941)	9
United States v. Johnson, Smathers & Rollins, 67 F. (2d) 121 (C. C. A. 4th, 1933)	10
Walker v. Brown, 165 U. S. 654 (1897)	10

STATUTES CITED IN PETITION.

	Page
Act of February 13, 1925, c. 229, § 1, 43 Stat. 928 (28 U. S. C. A. § 347 (a))	8
Hurd Act (36 Stat. 1167, 40 U. S. C. A. § 270)	2, 8, 10, 11
Miller Act (49 Stat. 793, 40 U. S. C. A. § 270a)	2, 11
R. S. New Jersey 2:60-212 (1932)	6, 11

TABLE OF CONTENTS OF BRIEF.

	Page
Summary of Argument	13
Argument	14
I. The Provision in Petitioner's Letter of Guaranty Placing the Situs in New Jersey for Purposes of Construction Does Not Constitute an Agreement That New Jersey Law Should Govern the Question Whether Petitioner's Undertaking Thereunder Had Subsequently Been Paid	14
II. Federal Law Governs the Right of Respondent to Apply Federal Funds Received From Federal Contractor, With Knowledge of Their Source, in Payment of a Debt Unrelated to the Federal Contract Instead of Applying the Funds to the Payment of Bills for Labor and Materials Incurred on the Federal Contract	16
III. Under Federal Law the Respondent Was Bound to Apply the $20,500.00 on Account of the Claims for Labor and Materials Covered in the Letter of Guaranty and Not to the Payment of a Debt Unrelated to It	19
IV. Under the Law of the State of New Jersey the Respondent Was Bound to Have Applied the $20,500.00 on Account of the Claims for Labor and Materials Specified in the Letter of Guaranty	21
Conclusion	23

CASES CITED IN BRIEF.

Page

Board of County Commissioners of the County of Jackson, Kansas v. United States, 308 U. S. 343 (1939) 17

Clearfield Trust Company v. United States, — U. S. —, 63 Sup. Ct. 573 (decided March 1, 1943) 17, 18

Deitrick, Receiver v. Greaney, 309 U. S. 190 (1940) .. 17

Erie Railroad Co. v. Tompkins, 304 U. S. 64 (1938).. 19

R. P. Farnsworth & Co., Inc. v. Electrical Supply Co., 112 F. (2d) 150 (C. C. A. 5th, 1940) 17, 19, 20

Grover v. Board of Education of Township of Franklin, 102 N. J. E. 415, 141 Atl. 81 (1928), affirmed in 104 N. J. E. 197, 144 Atl. 918 (1929)....21, 22, 23

Henningsen v. United States Fidelity and Guaranty Co., 208 U. S. 404 (908) 20

Martin v. National Surety Co., 300 U. S. 588 (1937).. 20

Morley Construction Co. v. Maryland Casualty Co., 300 U. S. 185 (1937) 20

O'Brien v. Western Union Telegraph Co., 113 F. (2d) 539 (C. C. A. 1st, 1940) 17

Prairie State Bank v. United States, 164 U. S. 227 (1896) 20

Royal Indemnity Co. v. United States, 313 U. S. 289 (1941) 17

Sola Electric Co. v. Jefferson Electric Co., — U. S. —, 63 Sup. Ct. 172 (decided Dec. 7, 1942)..... 19

United States v. Clearfield Trust Co., 130 F. (2d) 93, 95 (C. C. A. 3rd, 1942) 18

United States v. Hutcheson, 312 U. S. 219, 235 (1941) 23

United States v. Johnson, Smathers & Rollins, 67 F. (2d) 121 (C. C. A. 4th, 1933) 19

Walker v. Brown, 165 U. S. 654 (1897) 20

STATUTES CITED IN BRIEF.

	Page
Hurd Act (36 Stat. 1167, 40 U. S. C. A. § 270)	14, 17, 18
Miller Act (49 Stat. 793; 40 U. S. C. A. § 270 a, b, c, and d)	18
R. S. New Jersey 2:60-212 (1932)	22

IN THE

Supreme Court of the United States.

No. . October Term, 1942.

THE AETNA CASUALTY AND SURETY COMPANY,
Petitioner,

v.

FIRST CAMDEN NATIONAL BANK AND TRUST COMPANY,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, The Aetna Casualty and Surety Company, prays that a writ of certiorari be issued to review the final judgment of the United States Circuit Court of Appeals for the Third Circuit, entered on December 4, 1942, (R. 161), rehearing denied January 8, 1943 (R. 169), which judgment affirmed a final judgment of the District Court of the United States for the District of New Jersey, entered in favor of respondent and against the petitioner in the sum of $20,500.00.

SUMMARY AND STATEMENT OF MATTER INVOLVED.

A civil action was instituted by the respondent in the District Court of the United States for the District of New Jersey to recover from petitioner the sum of $20,500.00 under the terms of a written undertaking or guaranty con-

tained in a letter dated February 23, 1937 (R. 3-9, 120), which is set forth in succeeding paragraphs.

Petitioner was surety on a bond running to the United States taken pursuant to the provisions of the Hurd Act (36 Stat. 1167, 40 U. S. C. A. § 270), which has since been replaced by the Miller Act (49 Stat. 793, 40 U. S. C. A. § 270a). The bond, in accordance with the statute, guaranteed the faithful performance of the contract and the payment of labor and material bills. Certain labor and material bills were incurred which the contractor was unable to pay as they became due and for which the petitioner was ultimately liable under its bond. By the aforesaid letter to respondent (R. 6-8) petitioner (a) approved the correctness of a list of bills therein set forth and admitted its liability for their payment; (b) guaranteed that, if respondent took assignments of the bills listed, the petitioner would recognize each assignment and pay the bill evidenced thereby within six months after the final settlement of the construction contract, or at all events not later than February 23, 1938; and (c) stated that "the situs of this guaranty is New Jersey and shall be construed under the laws of said state." The letter in full is as follows, excepting only the list of the claimants and their bills:

"THE AETNA CASUALTY AND SURETY COMPANY
HARTFORD, CONNECTICUT

Fidelity and Surety Claim
Department February 23, 1937

First Camden National Bank & Trust Company,
Camden, N. J.

Re: S-18577—William Eisenberg & Sons, Inc.

Gentlemen:

Heretofore, on or about the 6th day of March, 1935 the Aetna Casualty & Surety Company, as surety, ex-

ecuted a contract bond running to the United States of America in the amount of $412,757.07, which said bond, in accordance with the provisions of the Hurd Act (40USCA270) guaranteed the faithful performance by William Eisenberg & Sons, Inc. of a contract with the Government for the construction of a dam at Beach City, Ohio, and payment of all bills for labor and materials incurred in connection therewith. We are informed that the value of work done to date under this contract amounts to approximately $660,251.58, and that the contractor has already received payments of $616,745.82, leaving retained percentage 'earned' in the approximate amount of $43,000.20.

It appears that the contractor is heavily indebted for labor and material bills, and while the responsibility of the Aetna as surety for the actual payment of such bills does not accrue until six months after the final settlement of the contract, its liability for this eventual payment is nevertheless fixed and definite for all labor and material bills which may be shown to have been incurred in connection with the project.

The contractor has informed us that he desires to borrow from you the sum of $30,000 to be used for the sole purpose of paying the following bills for material and labor incurred in the project above mentioned:

. . . . .

(next follows a list of the claimants and the amounts of their respective bills, the total of which amounts to $29,912.36)

. . . . .

We are further informed that you will take as security for this loan an assignment from each material and labor claimant of all of his rights of every description against this Company on the aforesaid bond executed for William Eisenberg & Sons, Inc. Being de-

sirous of assisting the contractor in procuring such loan, and in consideration of your making such loan to them, and as an inducement to you so to do, it is hereby agreed as follows:

(1) We affirm our aforesaid bond to be a valid and subsisting obligation, and further affirm that it is unqualifiedly liable for the bills hereinbefore listed in the amounts indicated above, and we hereby estop ourselves from denying the fact in any court to your prejudice.

(2) If you take assignments of such bills, and claims, on a form similar to the one attached hereto, or on any other appropriate form, we hereby agree to recognize such assignment to the fullest extent, and agree to pay the bill evidenced thereby, without interest, however, or so much thereof as remains unpaid at the expiration of six months subsequent to the final settlement of the foregoing construction contract at all event, not later than one year from February 23, 1937.

The situs of this guaranty is New Jersey and shall be construed under the laws of said State.

Trusting this is satisfactory, we are,

Yours very truly

THE AETNA CASUALTY AND SURETY COMPANY

By WILMOT SMITH
Vice-President

Attest A. R. Sexton
Secretary

CC Thomas J. Marshall, Attorney
Philadelphia, Pa.
William Eisenberg & Sons, Inc.
Camden, N. J."

(R 6-8.)

In reliance upon the said letter, the respondent lent to the contractor, the principal in petitioner's bond, the sum of Twenty Nine Thousand Nine Hundred Twelve Dollars and Thirty Six Cents ($29,912.36) and took assignments of the bills listed in the letter aggregating that amount (R. 122). In due course, the petitioner paid the respondent Nine Thousand Four Hundred Twelve Dollars and Thirty Six Cents ($9,412.36) which represented so much of the principal and interest of the original loan made to the contractor as exceeded Twenty Thousand Five Hundred Dollars ($20,500.00), but petitioner refused to pay the Twenty Thousand Five Hundred Dollars ($20,500.00) for reasons which will presently appear, and the respondent then brought the present suit.

Prior to the suit the contractor received the final payment from the United States on the contract bonded by the petitioner (R. 122). From that payment the contractor paid the respondent, who had full knowledge of the source of said moneys, the sum of Twenty Thousand Five Hundred Dollars ($20,500.00) (R. 122, 133). The respondent, however, did not apply the said sum so received to the assigned bills for labor and materials referred to in the letter of guaranty, but took said payment for the discharge of an unsecured debt which the contractor owed the respondent on another and disconnected matter (R. 122, 130).

The petitioner defended against respondent's claim for said Twenty Thousand Five Hundred Dollars ($20,500.00) on the ground that the promises contained in said letter had been legally satisfied in their entirety and that the claims for labor and materials listed therein had been fully discharged and paid when the respondent received from the contractor the payment of the said sum of Twenty Thousand Five Hundred Dollars ($20,500.00).

Both courts below held in substance:

(1) That the matter in controversy was governed by New Jersey law and not federal law; that if there could be any doubt of the correctness of that conclusion as a general proposition, that doubt was settled in this case by the provision in the letter above mentioned providing "that the situs of this guaranty is New Jersey and shall be construed under the laws of said state". (R. 8.)

(2) That under the New Jersey law as construed by its highest court in the case of *Grover v. Board of Education of Township of Franklin,* 102 N. J. E. 415, 141 Atl. 81 (1928) aff. in 104 N. J. E. 197, 144 Atl. 918 (1929), the respondent was within its rights in applying the payment in the manner already described.

(Apparently neither court attached any significance to the fact that the legislature of New Jersey in 1932 and subsequent to the *Grover* case had enacted a statute which was specifically designed to change the rule of law for New Jersey which the *Grover* case had laid down. The said statute provides:

> "All money paid by the State of New Jersey or by any agency, commission or department thereof, or by any county, municipality, or school district in the state, to any person pursuant to the provisions of any contract for any public improvement made between any such person and the state or any agency, commission or department thereof, or any county, municipality or school district in the State, shall constitute a trust fund in the hands of such person as such contractor, until all claims for labor, materials and other charges incurred in connection with the performance of such contract shall have been fully paid." *R. S. New Jersey* 2:60-212 (1932).

(3) That if federal law governed the case the respondent would be compelled to apply the money received to the discharge of the debt for which petitioner would otherwise have been responsible.

The case was tried before the Honorable Phillip Forman without a jury (R. 1). The Trial Judge entered judgment in favor of the respondent and against the petitioner in the amount of Twenty Thousand Five Hundred Dollars ($20,500.00) (R. 136).[1]

An appeal was taken by the petitioner to the United States Circuit Court of Appeals for the Third Circuit from said judgment of $20,500.00. After argument before Circuit Judges Maris, Jones and Goodrich, the Court-below filed a decision affirming the judgment of the District Court (R. 154). The opinion was written by Circuit Judge Goodrich (R. 154-161). Subsequently, a petition for rehearing was presented to the United States Circuit Court of Appeals for the Third Circuit (R. 162-168), and on January 8, 1943, said petition for rehearing was denied (R. 169).

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered on December 4, 1942 (R. 161) and a petition for rehearing was denied January 8, 1943 (R. 169).

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[1] The petitioner had counter-claimed for moneys which it alleged had been misapplied by respondent in payment of interest on an unsecured loan of the contractor and also sued the contractor and two of its officers as third party defendants (R. 11, 12, 120, 121). The Trial Judge dismissed petitioner's counter-claim but gave judgment for petitioner on its claims against said third party defendants (R. 135, 136). No appeal, however, has been taken from any of said judgments.

The jurisdiction of this Court to review said proceedings on a writ of certiorari is provided by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229, § 1, 43 Stat. 928 (28 U. S. C. A. § 347 (a)).

OPINIONS.

An opinion was filed on March 10, 1942, by the Honorable Phillip Forman (R. 124). It is reported in 43 F. Supp. 596. The opinion of the United States Circuit Court of Appeals for the Third Circuit, written by Circuit Judge Goodrich, was filed on December 4, 1942 (R. 154), and is reported in 132 F. (2d) 114.

QUESTIONS PRESENTED.

1. Did not the Courts-below err in holding that the provision in petitioner's letter of guaranty, which places the situs in New Jersey for purposes of construction, makes New Jersey law govern, not only the extent of the obligation assumed by petitioner in said letter (which is admitted) but also the further and separate question, whether payment of the debt has in fact been made through a misapplication by respondent of federal funds contrary to the rights of petitioner as surety under the Hurd Act?

2. Since there is no contractual provision in the letter controlling the question, do not federal law and decisions govern the right of a creditor to apply federal funds received from a federal contractor, with knowledge of their source, in payment of a debt unrelated to the federal contract instead of applying them to the payment of unpaid labor and material bills in its hands incurred on the federal contract out of which the fund arose?

3. If federal law and decisions govern, is not petitioner entitled thereunder to a judgment?

4. Even if state law governs, is not petitioner nevertheless entitled to a judgment due to the fact that a legislative declaration of the law by that State, which was made after the court decision upon which the Courts-below relied and before the happening of any of the events out of which the instant case arose, changed the policy or the law of the state as announced by said court decision so that the present policy or law of the state compels a judgment for petitioner?

REASONS FOR GRANTING THE PETITION.

The United States Circuit Court of Appeals for the Third Circuit has misconstrued the letter of guaranty since there is nothing in that letter which even suggests that a question of payment or misapplication *vel non* would arise or, if it did arise, that those questions would be taken out of the orbit of federal decisions.

The petition should be granted because the United States Circuit Court of Appeals for the Third Circuit, in holding that the legal effect of the respondent's application of the contractor's money to claims foreign to the construction contract instead of to the assigned claims for labor and materials was governed by state and not federal law, has decided a federal question in conflict with applicable decisions of your Honorable Court. *Board of County Commissioners of the County of Jackson, Kansas v. United States,* 308 U. S. 343 (1939); *Deitrick, Receiver v. Greaney,* 309 U. S. 190 (1940); *Royal Indemnity Co. v. United States,* 313 U. S. 289 (1941); *D'Oench, Duhme & Co., Inc. v. Federal Deposit Insurance Corporation,* 315 U. S. 447 (1942), as well as in conflict with decisions of other Circuit Courts

of Appeals, *R. P. Farnsworth & Co., Inc. v. Electrical Supply Co.*, 112 F. (2d) 150 (C. C. A. 5th, 1940); *O'Brien v. Western Union Telegraph Co.*, 113 F. (2d) 539 (C. C. A. 1st, 1940).

The decision of the Court-below is likewise in conflict with decisions of the United States Circuit Courts of Appeals for the Fourth Circuit and for the Fifth Circuit, which hold that, under circumstances similar to those in this case, the surety is entitled to have the payment from the contractor applied to the debt for which it is bound. *United States v. Johnson, Smathers, & Rollins*, 67 F. (2d) 121 (C. C. A. 4th, 1933); *R. P. Farnsworth & Co., Inc. v. Electrical Supply Co.*, 112 F. (2d) 150 (C. C. A. 5th, 1940).

The Court-below has decided an important question of federal law not settled by your Honorable Court and in a way probably in conflict with applicable decisions of your Honorable Court concerning rights and liabilities of parties affected by the provisions of the Hurd Act, *supra*, *Martin v. National Surety Co.*, 300 U. S. 588 (1937); *Morley Construction Co. v. Maryland Casualty Co.*, 300 U. S. 185 (1937); *Walker v. Brown*, 165 U. S. 654 (1897); *Prairie State Bank v. United States*, 164 U. S. 227 (1896); *Henningsen v. United States Fidelity & Guaranty Co.*, 208 U. S. 404 (1908).

Finally, if the question of the application of the contractor's money be considered one of local law (which the petitioner does not concede), the decision of the Court-below is in conflict with the applicable local law as enacted by the legislature of the State of New Jersey, but as yet unannounced by the courts of said state. R. S. New Jersey 2:60-212 (1932).

The present controversy presents important questions of federal policy, of comity between state and federal

courts, of supremacy of federal decisions over state decisions in federal matters, and supremacy of legislative acts over prior state decisions. The decision of the Court-below does not adequately consider all of these questions but is based upon a misconception of the nature of the petitioner's defense and of the law applicable thereto, disregarding the decisions of other United States Circuit Courts of Appeals under the erroneous conclusion that state law alone was applicable and further misapplying the state law, after ruling that it was applicable.

The determination of the questions presented is of utmost importance, not only to the petitioner, but also to all contractors and their sureties, who have or will give bonds required under the Hurd Act, *supra*, or its successor, the Miller Act, *supra*. The duties, privileges, rights and obligations of parties affected by federal legislation which establishes a scheme of regulation such as that embraced in the Hurd Act, *supra*, and the Miller Act, *supra*, should be governed by uniform federal rules and should not be affected by the legal confusion, uncertainty and differences which would result if such parties' rights and obligations would be determined by the varying laws of the several states.

Respectfully submitted,

THE AETNA CASUALTY AND SURETY COMPANY,

By JOSEPH W. HENDERSON,
Of Counsel.

STATE OF PENNSYLVANIA,
COUNTY OF PHILADELPHIA, } *ss.:*

JOSEPH W. HENDERSON, being duly sworn according to law, deposes and says that he is counsel for the petitioner herein and that the facts set forth in the foregoing petition are true and correct to the best of his knowledge, information and belief.

JOSEPH W. HENDERSON.

Sworn to and subscribed before me this 1st day of April, A. D. 1943.

HARRISON G. KILDARE,
(Seal) *Notary Public.*
My Commission expires January 25, 1947.

I hereby certify that I have examined the foregoing petition and that in my opinion it is well founded and entitled to the favorable consideration of the Court and that it is not filed for the purpose of delay.

JOSEPH W. HENDERSON,
Counsel for Petitioner.

IN THE SUPREME COURT OF THE UNITED STATES.

No. . October Term, 1942.

The Aetna Casualty and Surety Company,
Petitioner,

v.

First Camden National Bank and Trust Company,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

For Opinions Below, Jurisdiction, Statement of the Case and Questions Presented, see pages 1 to 9 of the Petition.

SUMMARY OF ARGUMENT.

I. THE PROVISION IN PETITIONER'S LETTER OF GUARANTY PLACING THE SITUS IN NEW JERSEY FOR PURPOSES OF CONSTRUCTION DOES NOT CONSTITUTE AN AGREEMENT THAT NEW JERSEY LAW SHOULD GOVERN THE QUESTION WHETHER PETITIONER'S UNDERTAKING THEREUNDER HAD SUBSEQUENTLY BEEN PAID.

II. FEDERAL LAW GOVERNS THE RIGHT OF RESPONDENT TO APPLY FEDERAL FUNDS RECEIVED FROM FEDERAL CONTRACTOR, WITH KNOWLEDGE OF THEIR SOURCE, IN PAYMENT OF A DEBT UNRELATED TO THE FEDERAL CONTRACT INSTEAD OF APPLYING THE FUNDS TO THE PAYMENT OF BILLS FOR LABOR AND MATERIALS INCURRED ON THE FEDERAL CONTRACT.

III. UNDER FEDERAL LAW THE RESPONDENT WAS BOUND TO APPLY THE $20,500.00 ON ACCOUNT OF THE CLAIMS FOR LABOR AND MATERIALS COVERED IN THE LETTER OF GUARANTY AND NOT TO THE PAYMENT OF A DEBT UNRELATED TO IT.

IV. UNDER THE LAW OF THE STATE OF NEW JERSEY THE RESPONDENT WAS BOUND TO HAVE APPLIED THE $20,500.00 ON ACCOUNT OF THE CLAIMS FOR LABOR AND MATERIALS SPECIFIED IN THE LETTER OF GUARANTY.

Argument.

I. THE PROVISION IN PETITIONER'S LETTER OF GUARANTY PLACING THE SITUS IN NEW JERSEY FOR PURPOSES OF CONSTRUCTION DOES NOT CONSTITUTE AN AGREEMENT THAT NEW JERSEY LAW SHOULD GOVERN THE QUESTION WHETHER PETITIONER'S UNDERTAKING THEREUNDER HAD SUBSEQUENTLY BEEN PAID.

As an inducement to respondent to lend $29,912.36 to the contractor for the purpose of paying laborers and materialmen under Government contract, the petitioner, who was surety on contractor's bond required by the Hurd Act (36 Stat. 1167, 40 U. S. C. A. § 270) to cover that contract, guaranteed in writing to the respondent:—

1. That its bond was a valid obligation and that it was liable for the payment of stated bills for labor and materials; and

2. That if respondent took assignments of the aforesaid bills the petitioner would recognize each assignment and "pay the bill evidenced thereby, without interest, however, or so much thereof as remains unpaid at the expiration of six months subsequent to the final settlement of the foregoing construction contract at all event, not later than one year from February 23, 1937". (R. 6-8.)

The agreement further provided that "the situs of this guaranty is New Jersey and shall be construed under the laws of said state". (R. 8.)

The petitioner has always recognized its obligation thereunder, to wit, to pay the respondent within one year

the amount of said claims or so much thereof as then may not have been paid or discharged. However, petitioner has denied any liability to respondent for the sum of $20,500.00 on the ground that the claims which the petitioner guaranteed had been paid and discharged by respondent's receipt from the contractor of moneys which the respondent knew came from said construction contract notwithstanding its application by respondent to other claims foreign to the contract. This defense is not dependent upon the construction of the guaranty, for it does not arise out of the guaranty but out of matters which are separate and distinct therefrom and which occurred long after its execution. The defense is a plea of payment, but it is not rendered the less valid merely because the promise in the guaranty is absolute on its face.

The Courts-below have misconstrued the letter of guaranty in holding that the provision placing the situs in New Jersey for purposes of construction makes New Jersey law govern not only the extent of the obligation assumed by petitioner (which obligation has always been admitted) but also the petitioner's affirmative defense that the payment of the debt has in fact been made through a misapplication by respondent of funds from a federal contract contrary to the rights of petitioner.

There is nothing in the letter of guaranty which even suggests that the question of payment or misapplication *vel non* would arise, or if it did arise, that those questions would be taken out of the orbit of federal decisions.

The petitioner has always conceded that New Jersey law by virtue of the provision in its guaranty governs the construction and extent of its obligation. However, it has also consistently maintained that said provision is not ap-

plicable to petitioner's defense. The letter of guaranty offers no solution in any of its provisions as to whether federal or state law should be applied in determining the question whether payment has in fact been made in satisfaction of petitioner's undertaking. In fact, the letter in no way indicates that either the petitioner or the respondent considered either the possibility of that question arising or, if such a question were to arise, what law should govern.

See petitioner's Petition for Rehearing filed in the United States Circuit Court of Appeals for a further and more detailed discussion of this proposition. (R. 162, 163, 164.)

We, therefore, submit that the provision in the letter of guaranty placing the situs in New Jersey for purposes of construction has no application whatsoever to the questions involved in this proceeding, namely, has the debt for which petitioner is liable been paid and under what law is said question to be determined?

II. FEDERAL LAW GOVERNS THE RIGHT OF RESPONDENT TO APPLY FEDERAL FUNDS RECEIVED FROM FEDERAL CONTRACTOR, WITH KNOWLEDGE OF THEIR SOURCE, IN PAYMENT OF A DEBT UNRELATED TO THE FEDERAL CONTRACT INSTEAD OF APPLYING THE FUNDS TO THE PAYMENT OF BILLS FOR LABOR AND MATERIALS INCURRED ON THE FEDERAL CONTRACT.

It is well established that, where Congress has enacted legislation concerning a subject matter, all questions relating to the duties, privileges, and liabilities of the parties affected by that legislation must be governed by uniform

federal rules. ***Royal Indemnity Co. v. United States,*** 313 U. S. 289 (1941); ***Board of County Commissioners of the County of Jackson, Kansas v. United States,*** 308 U. S. 343 (1939); *Clearfield Trust Company v. United States,* — U. S. —, 63 Sup. Ct. 573 (decided March 1, 1943, but not officially reported); *Deitrick, Receiver, v. Greaney,* 309 U. S. 190 (1940); *R. P. Farnsworth & Co., Inc. v. Electrical Supply Co.,* 112 F. (2d) 150 (C. C. A. 5th, 1940); *O'Brien v. Western Union Telegraph Co.,* 113 F. (2d) 539 (C. C. A. 1st, 1940).

It is within the province of Congress, and not state legislatures or courts, to say upon what terms and conditions and in favor of what classes of persons federal funds are or cease to be chargeable with trusts, liens or equities, and, in the absence of specific provision in such legislation, "it is for the federal courts to fashion the governing rule of law according to their own standards". *Clearfield Trust Company v. United States, supra; Deitrick, Receiver, v. Greaney, supra; O'Brien v. Western Union Telegraph Co., supra.*

This case concerns the application of Government funds contrary to rights which became vested in the petitioner by virtue of the Hurd Act, *supra.* There is no question of the identity of the fund which the respondent received nor of the fact that the respondent "had knowledge of the source of payment which it applied to its general account" instead of to the payment of the assigned bills for labor and materials. (R. 133.) The petitioner's bond had been required under the Hurd Act, *supra,* and the petitioner's rights with respect to monies paid by the United States under the public work contract find their origin in the statutory regulation enacted by Congress. It, therefore, follows

—in the absence of a specific agreement to the contrary—that questions concerning the application of said funds and the rights of the contractor's surety must be determined by a uniform rule which can only be obtained through the federal decisions. "It would lead to great diversity in result by making identical transactions subject to the vagaries of the law of the several states. The desirability of a uniform law is plain." *Clearfield Trust Co. v. United States, supra.*

The Court-below erred in holding that the question in this case was not a federal one merely because suit had not been instituted on the petitioner's bond but on a letter of guaranty, and also because the federal court obtained jurisdiction on the ground of diversity of citizenship. Neither of these two facts constituted a justifiable reason for declining to apply federal law. *United States v. Clearfield Trust Co.*, 130 F. (2d) 93, 95 (C. C. A. 3rd, 1942). The right to sue on the petitioner's bond is but one of the provisions of the Hurd Act. Furthermore, we know of no decision in which your Honorable Court has ruled that federal law is not applicable in a proceeding because jurisdiction is based on diversity of citizenship. Since state courts, as well as federal courts, are bound by federal law as enacted by Congress, the fact that jurisdiction in this case is based on a diversity of citizenship has no bearing on the instant question.

If the rights and liabilities of the petitioner are not determined exclusively by federal law, the Congressional purposes expressed through the Hurd Act, *supra*, and its successor, the Miller Act, (49 Stat. 793; 40 U. S. C. A. § 270 a, b, c, and d) will be defeated, and the application of varying state rules of liability based solely on the law of the forum will destroy all uniformity.

The doctrine of *Erie Railroad Co. v. Tompkins*, 304 U. S. 64 (1938), "is inapplicable to the areas of judicial decision in which the policy of the law is so designated by the sweep of Federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law". *Sola Electric Co. v. Jefferson Electric Co.*, — U. S. —, 63 Sup. Ct. 172 (decided December 7, 1942, but not officially reported).

The Court-below, therefore, erred in refusing to apply federal law.

III. UNDER FEDERAL LAW THE RESPONDENT WAS BOUND TO APPLY THE $20,500.00 ON ACCOUNT OF THE CLAIMS FOR LABOR AND MATERIALS COVERED IN THE LETTER OF GUARANTY AND NOT TO THE PAYMENT OF A DEBT UNRELATED TO IT.

The United States Circuit Courts of Appeals for the Fourth Circuit and for the Fifth Circuit have uniformly held that under circumstances similar to those in this case, a surety is entitled to have payments from the contractor applied against the debt for which the surety is bound. *United States v. Johnson, Smathers, & Rollins*, 67 F. (2d) 121 (C. C. A. 4th, 1933); *R. P. Farnsworth and Co., Inc. v. Electrical Supply Company, supra.*

In *United States v. Johnson, Smathers, & Rollins, supra*, claim was made by a company which had furnished the subcontractor materials for use in a public works contract. The company, with knowledge that the moneys came from the public works project, nevertheless applied payments to another debt of the sub-contractor and then sued on the bond which had been required by the Hurd Act. The Court

held that the application was wrongful and that the surety was entitled to have the payment applied to the debt for which it was bound.

Similarly, in *R. P. Farnsworth and Co., Inc. v. Electrical Supply Company, supra,* materials had been furnished by an electrical supply company to a subcontractor who subsequently endeavored to apply moneys which said subcontractor received from a public works project to other items of its account with the subcontractor which were older and had no connection with the public work. The Court specifically held that the materialmen could not make such application to the prejudice of the principal and the surety on the bond.

Such holdings are consonant and in line with the decisions of your Honorable Court concerning the rights and liabilities of parties affected by the provisions of the Hurd Act, *supra,* as well as within the spirit of the Act. *Martin v. National Surety Co.,* 300 U. S. 588 (1937); *Morley Construction Co. v. Maryland Casualty Co.,* 300 U. S. 185 (1937); *Walker v. Brown,* 165 U. S. 654 (1897); *Prairie State Bank v. United States,* 164 U. S. 227 (1896); *Henningsen v. United States Fidelity and Guaranty Co.,* 208 U. S. 404 (1908).

The petitioner in this case is not seeking to recover for itself $20,500.00 which the respondent has misapplied, but desires and insists that the respondent properly apply the said money which, with knowledge of its source, namely, a federal contract, the respondent received from the contractor and which should have been applied to the labor and material bills covered by the letter of guaranty. Such application will not work to the prejudice of the respondent, but will merely place it in the same position which it would have

occupied if the moneys had been properly applied since it has neither parted with security nor placed itself in a different position without notice of the source of the funds, because the contractor's note to which the sum was applied was an unsecured obligation. See section III in petitioner's Petition for Rehearing filed in the United States Circuit Court of Appeals (R. 162, 167).

Thus, it is clear that under federal law the respondent was bound to have applied the $20,500.00 on account of the claims for labor and materials specified in the letter of guaranty and judgment should have been entered for the petitioner and against respondent.

IV. UNDER THE LAW OF THE STATE OF NEW JERSEY THE RESPONDENT WAS BOUND TO HAVE APPLIED THE $20,500.00 ON ACCOUNT OF THE CLAIMS FOR LABOR AND MATERIALS SPECIFIED IN THE LETTER OF GUARANTY.

If the question of the application of the contractor's money be considered one of local law (which the petitioner does not concede) the Court-below erred in ruling on the authority of *Grover v. Board of Education of Township of Franklin*, 102 N. J. E. 415, 141 Atl. 81 (1928), affirmed in 104 N. J. E. 197, 144 Atl. 918 (1929), that under local law the respondent, notwithstanding its knowledge of the source of the funds, could apply the same to an unsecured claim of the contractor. While it may be argued that the facts in the *Grover* case distinguish that case from the present case and that the specific problem in this controversy, therefore, is still undetermined by the courts of New Jersey, nevertheless, assuming that the *Grover* case is controlling, we submit that subsequent to that decision the law of that state

has been changed because in 1932 the legislature provided by statute that:—

> "All money paid by the State of New Jersey or by any agency, commission or department thereof, or by any county, municipality, or school district in the state, to any person pursuant to the provisions of any contract for any public improvement made between any such person and the state or any agency, commission or department thereof, or any county, municipality or school district in the State, shall constitute a trust fund in the hands of such person as such contractor, until all claims for labor, materials, and other charges incurred in connection with the performance of such contract shall have been fully paid." *R. S. New Jersey* 2:60-212 (1932).

While the legislature did not pretend to deal with federal funds (a matter over which it had no power to legislate, even if it had so attempted), the statute is as extensive and inclusive as the court's decision in the *Grover* case (which only concerned state funds) and so effectively overruled the law as enunciated in the *Grover* case that, if the same question were now to come before the New Jersey court, the decision would have to be different from the one handed down in the *Grover* case.

Since the law of New Jersey, as formerly enunciated by the *Grover* case, has thus been changed by legislative mandate and since state funds are specifically considered trust funds until all claims for labor and materials incurred in connection with a government contract have been fully paid, so has the law of New Jersey been changed with respect to federal funds, and they too must be considered trust funds until all claims for labor and materials have been fully paid. Thus the state legislature, supreme in de-

claring the law of its state concerning its own public works, has effectively changed the rule enunciated by the *Grover* case so far as concerns the federal public works, so far as it has been able so to do.

> "The appropriate way to read legislation in a situation like the one before us, was indicated by Mr. Justice Holmes on circuit: 'A statute may indicate or require as its justification a change in the policy of the law, although it expresses that change only in the specific cases most likely to occur in the mind. The Legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognized and obeyed. The major premise of the conclusion expressed in a statute, the change of policy that induces the enactment, may not be set out in terms, but it is not an adequate discharge of duty for the courts to say: We see what you are driving at, but you have not said it, and therefore we shall go on as before.' *Johnson v. United States*, 163 F. 30, 32." *United States v. Hutcheson*, 312 U. S. 219, 235 (1941)

CONCLUSION.

We submit that the Court-below should have held that the letter of guaranty contained no agreement as to whether federal or state law was applicable in determining the legal effect of the respondent's application of the $20,500.00 to unsecured obligations of the contractor unrelated to the public works contract. Therefore, the Court-below should have applied federal law and held that under federal law the claims for labor and materials listed in the letter of guaranty were discharged when the respondent received the said sum of $20,500.00 from the contractor, with knowledge of its source, since it was bound to have applied said sum to

the payment of said claims; or assuming that local law was applicable, without admitting the same, the Court-below should have reached the same conclusion upon the ground that under the state law as enacted by the legislature of New Jersey but as yet unannounced by the courts of that state the petitioner is entitled to judgment.

We, therefore, submit that petitioner's prayer for a writ of certiorari should be granted.

Respectfully submitted,

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Philadelphia, Pennsylvania,

April 1, 1943.

GEORGE M. BRODHEAD, JR.,
Of Counsel.

Office - Supreme Court, U. S.
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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 880.

THE AETNA CASUALTY AND SURETY COMPANY,
Petitioner,

v.

FIRST CAMDEN NATIONAL BANK AND TRUST COMPANY,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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TABLE OF CONTENTS

PAGE

I. Statement of the Case 1

II. Argument 7

Introduction 7

III. Answer to Questions Presented 8

IV. Answer to Reasons 14

V. Discussion of Cases Cited by Petitioner 16

VI. The Petitioner has not Shown Sufficient Reasons Entitling it to a Writ of Certiorari 22

VII. Conclusion 23

CASES CITED

American Lumberman's Mutual Casualty Co. v. Bradley Construction Co., 13 Atl. 2nd 783, 127 N. J. E. 500 ..... 13, 14

Board of County Commissioners of the County of Jackson, Kansas v. United States, 308 U. S. 343 (1939) 16

Clearfield Trust Company v. United States,—U. S.— 63 Sup. Ct. 573 (decided March 1, 1943) 18

Deitrick, Receiver, v. Greaney, 309 U. S. 190 (1940) ... 16

Table of Contents

PAGE

D'Oench, Duhme & Co., Inc. v. Federal Deposit Ins. Corp., 315 U. S. 447 (1942) 17

Erie Railroad Co. v. Tompkins, 304 U. S. 64 (1938) 5, 7, 9, 16, 20, 21, 22

R. P. Farnsworth & Co., Inc. v. Electrical Supply Co., 112 F. (2d) 150 (C. C. A. 5th, 1940) 18, 19, 20

Grover v. Board of Education of Township of Franklin, 102 N. J. E. 415, 141 Atl. 81 (1928), affirmed in 104 N. J. E. 197, 144 Atl. 918 (1929) 5, 18

Henningsen v. United States Fidelity and Guaranty Co., 208 U. S. 404 (1908) 21

Hoey v. Jarman, 39 N. J. L. 523; affirmed 40 N. J. L. 379 10

Martin v. National Surety Co., 300 U. S. 588 (1937) .. 20

Morley Construction Co. v. Maryland Casualty Co., 300 U. S. 185 (1937) 21

Newcomb v. Kloebleu, 77 N. J. L. 791; 74 Atl. Rep. 511 .. 10

O'Brien v. Western Union Telegraph Co., 113 F. (2d) 539 (C. C. A. 1st, 1940) 18

Palmer v. Hoffman, U. S. Supreme Court, decided October Term, 1942 23

Perkins v. Goodwin, 83 N. J. L. 471, 83 Atl. Rep. 87 ..10, 12

Prairie State Bank v. United States, 164 U. S. 227 (1896) 21

Table of Contents

PAGE

Royal Indemnity Co. v. United States, 313 U. S. 289 (1941) 17

Sola Electric Co. v. Jefferson Electric Co.,—U. S.— 63 Sup. Ct. 172 (decided Dec. 7, 1942) 19

Superior & C. Corp. v. John McCrane &c., Inc., 116 N. J. L. 435 ..... 10, 12

United States v. Johnson, Smathers & Rollins, 67 F. (2d) 121 (C. C. A. 4th, 1933) 17, 19

Walker v. Brown, 165 U. S. 654 (1897) 21

West v. American Telephone & Telegraph Co., 311 U. S. 223 14

STATUTES CITED

R. S. New Jersey 2:60-212 (1932) 13

IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 1942.

No. 880.

THE AETNA CASUALTY AND SURETY COMPANY,
Petitioner,

v.

FIRST CAMDEN NATIONAL BANK AND TRUST COMPANY,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

I. STATEMENT OF THE CASE.

The suit of the respondent, a National Bank located and doing business in Camden, New Jersey, against the petitioner, a corporation of the State of Connecticut, was a Civil Action in the District Court of United States for the District of New Jersey, to recover the sum of $20,500.00

with interest thereon, being the balance due on a guaranty of the petitioner, dated February 23, 1937. (R. 3 and 5)

The petitioner had entered into a written guaranty to pay the respondent the sum of $29,912.36, not later than one year from February 23, 1937. (R. 7 and 8) On August 1, 1938, petitioner paid the principal sum of $9,412.35 and interest from February 23, 1938, of $259.93, a total of $9,672.29, reducing the amount due on the guaranty to the sum of $20,500.00 (Ex. P-9 and P-10, R. 14 and 16), the sum for which suit was brought with interest (R. 5). The petitioner was surety on the bond of a contractor, William Eisenberg & Sons, Inc. for the faithful performance of a construction contract. The contractor had entered into this contract with the United States Government and reached a stage in the progress of the work where it needed money to pay certain bills for labor and materials. The petitioner being obligated to pay said bills and interested in avoiding a default upon the part of the contractor, induced the respondent to loan the contractor a sufficient sum to pay said bills. The respondent made the loan as requested upon the written guaranty of the petitioner (R. 5 and 8). The contractor had been a customer of the Bank and this relationship was known to the petitioner. The contractor was also indebted to the respondent at the time the guaranty was executed, and this fact was also known to the petitioner. (Ex. D-9, R. 112 and 113) The latter was also informed by the respondent in advance of the execution of the guaranty that the indebtedness was incurred in connection with the contract. (R. 67 and 68 and Ex. D-9 R. 113) The contractor continued to do business with the respondent after the execution of the guaranty not only as a depositor, but as a borrower. (R. 15-29) The contractor met its obligations with the Bank in the usual course, making payments of interest and principal. On or

about January 11, 1938, an unsecured note of $20,500.00 matured, (R. 18) and the Eisenbergs, who were officers of the contractor corporation, paid this unsecured note, upon surrender by the respondent of the note. This transaction was handled in the usual and regular course of business by the discount clerk of the respondent bank (R. 87), without the knowledge of its officers (R. 43 and 106). The contractor, in exchange for said note, gave a check in the amount of same, drawn against its general bank account, on deposit in the Northwestern Bank of Philadelphia (R. 89, 90, 99 to 106, incl.).

The guaranty (Ex. A. and R. 6, 7 and 8), sets forth the only contract between the respondent and the petitioner. The first approach for the loan guaranteed was made by a representative of the Surety Company (R. 52 and 65). There were preliminary conferences upon the part of the Bank with the representatives of the surety for the purpose of obtaining information as to the resources and liabilities of the contractor in connection with the contract. Letters were also exchanged upon the same subject (Exhibits, R. 7, 8, 9, 10, 110 to 116). There were also discussions as to the form of the guaranty (R. 52-57). The form (Ex. P-11, R. 117) at first submitted by the petitioner was disapproved (R. 72-74). The respondent insisted upon two provisions being added to the form originally submitted. 1, a definite date for the maturing of the obligation, entirely independent of the date of the settlement under the government contract, and 3, provisions as to the situs of the guaranty. These provisions so inserted upon the insistence of the plaintiff are as follows:

> "at all event, not later than one year from February 23, 1937."
>
> "The situs of this guaranty is New Jersey and shall be construed under the laws of said State." (R. 8)

The only condition imposed upon the Bank by the surety was that the Bank should take as security for the loan, an assignment from each material and labor claimant (R. 7, 8 and 138). This condition was fulfilled by the Bank. The Bank made the loan to the contractor taking its note, with the assignments and the guaranty as collateral. The surety resisted payment of the Bank's claim for the balance of $20,500.00 and interest and to the complaint filed an answer and counterclaim (R. 10-12). The respondent joined issue by filing a reply and answer to the counterclaim (R. 138). The allegations of the complaint were admitted. The issues raised by the petitioner involved only the special defenses in the answer and the allegations of the counterclaim. At the hearing there was no offer of proof of the allegations of the counterclaim. There was no proof that the officers of the Bank knew of the payment of the $20,500.00 at the time of its payment (President of the Bank (R. 106), Vice-President (R. 43), Israel Eisenberg (R. 86-90) and Harry Eisenberg (R. 141).

The Bank was not involved in the action between the petitioner as third party plaintiff and the Eisenbergs, and the findings of the court in that connection, are not binding upon it, nor is the testimony of the witnesses offered in connection with that case, not in the presence of representatives of the Bank binding upon the respondent (R. 78).

The Surety Company did not, in advance of the loan so guaranteed, give notice to the Bank that the proceeds of the contract still unpaid were impressed with an equitable lien, claim or trust of any character in its favor (R. 70).

The trial judge dismissed the counterclaim on the ground that there was no proof to sustain its allegations (R. 135), and also overruled the contention of the defendant, that it had an equitable lien or claim upon the proceeds of the contract superior to that of the plaintiff. The trial judge followed the rule established in the State of New Jersey

"since the suit is not brought upon the bond and under the Heard Act, 40 U. S. C. A. 270, but upon an undertaking of the defendant, directly to the plaintiff, and providing that 'the situs of this guaranty is New Jersey and shall be construed under the laws of said State.' We believe we are bound by the case of *Grover v. Bd. of Ed., Franklin Twp., supra; Erie R. Co. v. Tompkins,* 304 U. S. 64." (R. 134)

For the purpose of indicating the findings of fact and basis of decision of the Circuit Court of Appeals, attention is called to certain portions of the opinion of Judge Goodrich of the Court of Appeals, as follows:

> "We do not think that federal law is the sole determinant of this litigation. The bank is not suing on the bond on which the appellant is surety. If that were the case, the federal court would have jurisdiction not by virtue of diversity of citizenship and the amount in controversy, but by express mandate of the Heard Act, authorizing suit in the (fol. 165) federal court in the name of the United States, irrespective of the amount in controversy. 40 U. S. C. A. (1928) §270. Then federal law might well be controlling. See United States v. Clearfield Trust Co., 130 F. (2d) 93 (C. C. A. 3, 1942). But this is not a suit under the Heard Act, but an action upon a contract between non-governmental parties, the bank and the surety company. The forum is the federal court because of diversity of citizenship and a controversy involved more than $3,000. These jurisdictional facts were carefully alleged in the complaint. The federal court must therefore look to the applicable state law to determine the litigants' rights and liabilities flowing from the contract sued upon. The agreement between the bank and the surety was made after the surety and the con-

tractor had contracted with the United States and in view of a situation arising out of events which had occurred in the progress of performance of that agreement." (R. 156 and 157)

"The contract between the bank and the surety is governed by the law of New Jersey. The letter of the surety to the bank constituted an offer which was accepted in New Jersey by the bank when it made the loan there to the contractor. See Restatement, Conflict of Laws (1934) §324. The payment by the contractor to the bank also occurred in New Jersey. The surety's promise to pay the bank, if the occasion for such payment arose, was doubtless to be performed in that state. See Restatement, Conflict of Laws (1934) §355. And for whatever significance it may have (fol. 166) the offer of the surety company stated that the 'situs' of the contract was New Jersey. These considerations all point to the conclusion that the propriety of the bank's application of the contractor's payment is to be determined by New Jersey law. Erie R. R. v. Tompkins, 304 U. S. 64 (1938)." (R. 157)

"Here the two coincide. Whatever are the rights and obligations of the surety under its contract made pursuant to the Heard Act, those of the bank under the separate agreement which stands on its own feet must be given effect. Under that agreement, which is governed by New Jersey law, the conclusion is inescapable that the bank could apply the payment as it wished." (R. 159)

"Whatever the rights and liabilities of the parties might be if they were measured solely by a bond given under the Heard Act and transactions arising thereunder, here they have made a subsequent agreement which we find to be governed by New Jersey law. That law supports the plaintiff's claim. While it is true

that the form which equitable relief may take in a federal court is a matter of federal law, the substantive rights giving rise to such relief are measured by the rule, state or federal, which the facts make appropriate. In this case it is the law of New Jersey, correctly found and applied by the trial court." (R. 161)

There was a petition to the Circuit Court for a rehearing upon grounds similar to those now being urged in this Court and the same was denied. (R. 169).

II. ARGUMENT.

Introduction.

It is difficult to follow the petition and supporting brief in the order or the manner in which the points are stated. This brief will endeavor to answer the petition under the headings of "Questions Presented", "Reasons for Granting the Petition" and the argument of petitioner in support of the petition. The portion of the brief of petitioner devoted to the argument merely develops the points already set forth in the petition, and for that reason, and to avoid unnecessary repetition, this brief will discuss all of the points raised by petitioner in the order above set forth.

The decree sought to be reviewed resulted from a finding that the litigation below arose out of the contract between two citizens of different states, and that the federal court acquired jurisdiction because of the diversity of citizenship and the amount involved. The court below also found that the rights and liabilities of the parties depended wholly upon the contract sued upon. The doctrine of *Erie v.*

Tompkins, 304 U. S. 64, was therefore invoked, and the rule of law established in New Jersey followed, not only because the parties by their agreement, had bound themselves to be governed by the law of that State, but because the controversy between the parties was a New Jersey transaction.

III. ANSWER TO QUESTIONS PRESENTED.

The questions as presented by the petitioner do not correctly set forth the grounds upon which the decisions of the Court below rested. For that reason, I have called attention in the opening portion of this brief (p. 5) to several paragraphs of the opinion of Judge Goodrich as the best answer to the contention in this respect of petitioner.

The petitioner states his first question (p. 8 of petitioner's brief) as follows:

> "1. Did not the Courts-below err in holding that the provision in petitioner's letter of guaranty, which places the situs in New Jersey for purposes of construction, makes New Jersey law govern, not only the extent of the obligation assumed by petitioner in said letter (which is admitted) but also the further and separate question, whether payment of the debt has in fact been made through a misapplication by respondent of federal funds contrary to the rights of petitioner as surety under the Hurd Act?"

The Courts below did not base their decisions wholly upon the situs provision of the contract. In each Court, and especially in the appellate tribunal, there was a finding that the litigants had entered into a contract which was to

be the sole guide for determining their respective rights and liabilities. This finding, of course excluded all connection with or consideration of any other contract, and particularly the Government contract, to which the petitioner sought to couple the guaranty. Attention is called to the language of the opinion of Judge Goodrich, previously cited in this brief, as an answer to the construction of the petitioner as to the basis of the decision of the Court below (R. 157, 159 and 161).

The Courts below, having reached this conclusion, the absence of a federal question followed. Since the litigation was therefore in a federal court, based upon a diversity of citizenship, the substantive rights and liabilities arising out of the contract were governed by the rule of law in New Jersey, *Erie v. Tompkins, supra.* There was ample evidence to support the finding that the guaranty executed by the surety was separate and distinct from the Government contract. The documents were executed years apart, the surety bond to the Government March 6, 1935 (R. 3), the guaranty February 23, 1937 (R. 6). In the negotiations preceding the closing of the transaction between the parties, the surety proffered a form of guaranty (Ex. P-11, R. 117, 118, 119), which was rejected (R. 72-74). The Bank wanted an unqualified guaranty and insisted upon a provision that would mature the obligation independent of the date of settlement of the contract. It also demanded the insertion of a provision as to the situs of the transaction. This latter provision, in conjunction with the definite maturity date of the guaranty and the law of New Jersey, has an important bearing in ascertaining a construction of the contract, to the effect that it was an undertaking wholly detached from the Government contract. Attention is called to the attitude of the Courts of New Jersey toward a guaranty. In the first place, in the con-

struction of the guaranty, it must be borne in mind that it is to be construed most strongly against the guarantor.

Hoey v. Jarman, 39 N. J. L. 523; Aff'd 40 N. J. L. 379

Newcomb v. Kloebleu, 77 N. J. L. 791; 74 Atl. Rep. 511.

In *Hoey v. Jarman, supra,* at page 521, the Court said:

"The guaranty is for a payment at a fixed time."

In *Superior &c. Corp. v. John McCrane, &c., Inc.,* 116 N. J. L. 435, at p. 436, Justice Parker for the Court of Errors and Appeals, said:

"The suit is on a guarantee of payment * * * to recover in such a case the plaintiff need do no more than show the existence of the debt and that the principal debtor has not paid. The fact that plaintiff did not properly pursue some agreed remedy as against the principal debtor, or did not pursue it at all, does not affect the rights of recovery against the guarantor."

In this same case, Justice Parker also said:

"a guarantee of payment is a guarantee of payment."

In the guaranty there was a direct promise by the guarantor to pay the guaranty in a given event, based upon a specified consideration and moving from the guarantee, and is entirely independent of the enforceability of the contract against the other party thereto. *Perkins v. Goodwin,* 83 N. J. L. 471.

In the second question propounded by petitioner is this language:

> "Since there is no contractual provision in the letter controlling the question, do not federal law and decisions govern the right of a creditor to apply federal funds received from a federal contractor, with knowledge of their source, in payment of a debt unrelated to the federal contract instead of applying them to the payment of unpaid labor and material bills in its hands incurred on the federal contract out of which the fund arose?" (P. 8 of petitioner's brief).

This question is in effect defective for the same reason as the preceding question. It avoids a statement and a consideration of all the facts. If the rights and liabilities of the parties must be determined from the contract of guaranty, then the same situation prevails as previously discussed. As was said by Judge Goodrich for the Circuit Court of Appeals,

> "whatever are the rights and obligations of the surety under its contract made pursuant to the Heard Act, those of the bank under the separate agreement which stands on its own feet must be given effect." (R. 159)

The petitioner, in this question, invokes the federal law, since there is no contractual provision in the letter controlling the question. There is a provision in the guaranty that was intended to bind the parties, however, as to the forum that was to govern any controversy between them. There is no language in the guaranty that qualifies the absolute character of the promise of the guarantor to pay at any event in one year from February 23, 1937. The only condition imposed upon the bank by the guarantor was that the bank should take an assignment of the material bills. This step was taken for the protection of the surety. It was the petitioner who was concerned in this

respect, so as to be assured that its liability for the payment of the bills would be extinguished. The petitioner made no attempt to impose a condition upon the respondent that it must first resort to the assignments held as collateral and exhaust whatever remedies it might have in that connection before calling upon the petitioner.

> "To guarantee the payment of a sum of money in an appropriate context imports a direct undertaking to pay the sum in a given event and not a mere promise to become answerable for the default of another."
>
> *Perkins v. Goodwin*, 83 N. J. L. 471; 83 Atl. Rep. 87.

Payment was not made as guaranteed on February 23, 1938. There was nothing in the guaranty that restricted the bank to look for payment to the Government contract. In New Jersey the bank had the choice of several remedies. It could have sued under the Heard Act, or it could have brought suit against the contractor, but it was not required to pursue any of these remedies. Failure to pursue any of those remedies did not affect the rights of recovery against the guarantor. *Superior, &c. v. McCrane, supra.*

The third question is thus stated:

> "3. If federal law and decisions govern, is not petitioner entitled thereunder to a judgment?" (p. 9 of petitioner's brief.)

It is unnecessary to discuss at this time this third question, since the ruling sought to be reviewed was based upon the applicability of the New Jersey, and not the federal law to the facts found. I do not concede upon the facts of this case that petitioner would be entitled to judgment.

The fourth question is as follows:

> "4. Even if state law governs, is not petitioner nevertheless entitled to a judgment due to the fact that a legislative declaration of the law by that State, which was made after the court decision upon which the Courts-below relied and before the happening of any of the events out of which the instant case arose, changed the policy or the law of the state as announced by said court decision so that the present policy or law of the state compels a judgment for petitioner." (p. 9 of petitioner's brief.)

This fourth question challenges the ruling of the Circuit Court of Appeals as to the New Jersey law, contending that a legislative act of New Jersey, changed the decision invoked. The Grover case, supra, and the legislative act in question, since its passage, have been reviewed by the Courts of New Jersey. At no time has the doctrine of the Grover case, now under discussion, been modified, except as to the agencies covered by the language of the Act. On the contrary, our New Jersey courts have adhered to a strict construction of the language of the Act, R. S. New Jersey 2:60-212. As Vice Chancellor Berry in *American Lumberman's Mutual Casualty Co. v. Bradlay Construction Company,* 13 Atl. 2nd 783 at 785, 127 N. J. E. 500, said:

> "The purpose of this statute was explained in Stulz-Sickles Company v. Fredburn Construction Company, 114 N. J. Eq. 475, 478, 169 A. 27, to be to avoid the effect of the decision of this court in Grover v. Board of Education, 102 N. J. Eq. 415, 141 A. 81, 83, affirmed 104 N. J. Eq. 197, 144 A. 918."

The Vice Chancellor had before him the question of the construction of the Act. The proceeding was brought by a

receiver seeking an order directing the bank to pay him the sum of $1900. on the ground that the balance in said bank account at the time was charged with a trust fund, of which the bank had knowledge, and could not be applied to the payment of debts due from the defendant company to the bank. The notice as to the source of the money, imputed to the respondent in the present case, was of the character urged and rejected by Vice Chancellor Berry in *American Lumberman's Co. v. Bradley, supra.* The Vice Chancellor after detailing the circumstances imputing notice, among other things, said: "in my judgment, the circumstances of this case do not spell out notice to the bank that the balance of the defendant's account was a trust account." The case was affirmed 129 N. J. E. 278; 19 Atl. Rep. 2d, p. 243. In the affirming opinion, the Court of Errors held, that while the moneys under the statute were trust funds in the hands of the contractor—"these moneys were free of the trust when deposited in the general bank account of the contractor." In other words neither the Vice Chancellor nor the Appellate Court were influenced by any legislative policy to adopt a construction of the act broader than its language.

Moreover a federal court is not free to apply a different rule however desirable it may believe it to be, and even though it may think that the state court, may establish a different rule in some future litigation. *West v. American Telephone & Telegraph Co.,* 311 U. S. 223.

IV. ANSWER TO REASONS.

The reasons upon which the present application of the petitioner is based will be discussed in their order. In that connection, this brief is intended to answer that por-

tion of the petitioner's petition as set forth in his brief, as well as the other portion that is devoted to the argument. Under the heading of "Reasons for Granting the Petition", petitioner's first paragraph is thus stated:

> "The United States Circuit Court of Appeals for the Third Circuit has misconstrued the letter of guaranty since there is nothing in that letter which even suggests that a question of payment or misapplication vel non would arise or, if it did arise, that those questions would be taken out of the orbit of federal decisions." (p. 9 of petitioner's brief.)

An answer to this contention has been discussed in the previous part of this brief. Petitioner has failed to take into account all the facts and circumstances forming the basis for the decision of the Court of Appeals.

In the next paragraph under the heading of "Reasons for Granting the Petition" is this language:

> "The petition should be granted because the United States Circuit Court of Appeals for the Third Circuit, in holding that the legal effect of the respondent's application of the contractor's money to claims foreign to the construction contract instead of to the assigned claims for labor and materials was governed by state and not federal law, has decided a federal question in conflict with applicable decisions of your Honorable Court. Board of County Commissioners of the County of Jackson, Kansas v. United States, 308 U. S. 343 (1939); Deitrick, Receiver v. Greaney, 309 U. S. 190 (1940); Royal Indemnity Co. v. United States, 313 U. S. 289 (1941); D'Oench, Duhme & Co., Inc. v. Federal Deposit Insurance Corporation, 315 U. S. 447 (1942), as well as in conflict with decisions of other Circuit Courts of Appeals, R. P. Farnsworth

& Co., Inc. v. Electrical Supply Co., 112 F. (2d) 150 (C. C. A. 5th, 1940); O'Brien v. Western Union Telegraph Co., 113 F. (2d) 539 (C. C. A. 1st, 1940. (p. 9 of petitioner's brief.)

The Circuit Court of Appeals, in holding that the legal effect of the respondent's application of the contractor's money to claims foreign to the construction contract, was governed by State and not Federal law, did not decide a federal question in conflict with applicable decisions of this Court, as well as in conflict with decisions of other Circuit Courts of Appeal. If the Circuit Court of Appeals correctly applied the local law in accordance with the doctrine of *Erie v. Tompkins, supra,* then the contention of the petitioner is effectively answered.

V. DISCUSSION OF CASES CITED BY PETITIONER.

To sustain the affirmative of his proposition, petitioner cites six decisions, four rendered by this Court and two rendered by other Circuit Courts of Appeal.

The first decision, *Board of County Commissioners of the County of Jackson, Kansas v. United States,* 308 U. S. 343 (1939) so invoked, did not follow the local law, "since the origin of the right to be enforced is the Treaty." "Plainly, whatever rule we fashion is ultimately attributable to the Constitution, treaties or statutes of the United States." A right conferred upon Indians by treaties was being enforced in that case.

In the case of *Deitrick, Receiver v. Greaney,* 309 U. S. 190 (1940), the suit was by a receiver of a national bank, on a note knowingly given by one of its directors as a sub-

stitute among its assets for shares of its own stock illegally purchased and retained by the bank. There was a violation of an Act of Congress invoked. The question was held to be federal since this Court said that the judicial determination of the legal consequences which flow from acts condemned as unlawful by the National Bank Act involves decision of a federal not a state question. The Court, in its opinion in that case, had previously said "The National Bank Act constitutes by itself a complete system for the establishment and government of national banks."

The third decision, *Royal Indemnity Co. v. United States,* 313 U. S. 289 (1941), was a suit brought by the United States for money due the United States for income tax unpaid to the Collector of Internal Revenue. One of the questions for decision was the amount of interest to be recovered, and upon this point the Court said: "But the rule governing the interest to be recovered as damages for delayed payment of a contractual obligation to the United States is not controlled by state statute or local common law."

The other Supreme Court decision, *D'Oench, Duhme & Co., Inc. v. Federal Deposit Insurance Corporation,* 315 U. S. 447 (1942) was another case not based on diversity of citizenship. The respondent was a federal corporation and brought the suit under an Act of Congress authorizing it to sue and be sued in any court of law. The liability of the petitioner on the note, the Court said "involves a decision of a federal not a state question under the rule."

In the Circuit Court of Appeals case invoked, *United States v. Johnson, Smathers & Rollins,* 67 F. (2d) 121 (C. C. A. 4th, 1933), the suit was based upon a contractor's surety bond. The action was brought by and in the name of the United States for the use of the Crane Company. The court in that case followed "the federal rule announced by decisions in this and other federal circuits." The court

in its opinion in that case referred to the New Jersey rule, *Grover v. Bd. of Education* as being contrary to its view.

The facts in that case were altogether different from the one under review. That was a suit in the name of the United States on the surety bond and not between two citizens upon a contract in which the United States was not involved. Again is the question of the applicability of the rule applied in the court below. If the rule were correctly applied to the facts involved, there was no conflict. The federal rule was invoked since the suit was brought by the United States for the use of the Crane Company upon the contractor's surety bond.

Farnsworth & Co. v. Electrical Supply is answered in a subsequent part of this brief (p. 20).

The last case under this point cited by petitioner, *O'Brien v. Western Union Telegraph Co.*, 113 F. (2d) 539 (C. C. A. 1st, 1940) is in line with the prior decisions already discussed. The federal rule was invoked because the libellous telegraph upon which the plaintiff sought relief was an interstate message and there was involved the violation of an Act of Congress.

In the portion of his brief entitled "Argument" petitioner cited two other cases upon this point. But in each of them the federal rule was applied because the relief sought involved the United States or an Act of Congress.

In the case of *Clearfield Trust Company v. United States*, U. S., 63 Sup. Ct. 573 (decided March 1, 1943 but not officially reported), suit was brought by the United States on a check drawn on the Treasury of the United States for services rendered to the Works Progress Administration. This Court said:

> "The rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law. When the United States dis-

burses its funds or pays its debts, it is exercising a constitutional function or power. This check was issued for services performed under the Federal Emergency Relief Act of 1935, 49 Stat. 115. The authority to issue the check had its origin in the Constitution and the statutes of the United States."

In the *Sola Electric Company v. Jefferson* case, relief was sought upon an agreement that involved a violation of the Sherman Act. There was an agreement fixing the competitive sales price of articles moving interstate. Such agreements the court held are unlawful because prohibited by the Sherman Act. It was for that reason that the question there submitted for decision was held to be controlled by federal and not state law.

Under this same heading "Reasons for Granting Petition" page 10 of the brief, the petitioner also contends that the decision is in conflict with decisions of the United States Circuit Courts of Appeal for the Fourth Circuit and for the Fifth Circuit, which held that under circumstances similar to those in this case, the surety is entitled to have the payment from the contractor applied to the debt for which it is bound. The cases cited are: *United States v. Johnson, Smathers & Rollins,* 67 F. (2d) 121 (C. C. A. 4th, 1933); *R. P. Farnsworth & Co., Inc. v. Electrical Supply Co.,* 112 F. (2d) 150 (C. C. A. 5th, 1940). The facts are not similar to these two last cited cases. Both cases are on the contractor's surety bond. As already noted in this brief, the suit in the one case was brought in the name of the United States on the contractor's surety bond in the case of *United States v. Johnson, supra.* Federal decisions were applied because the rights and liabilities of the parties arose out of the bond sued upon. Attention is called to the previous discussion in this brief as to the dissimilarity of that case and the one under review.

The second case on this point cited by petitioner, *R. P. Farnsworth & Co., Inc. v. Electrical Supply Co.*, was also a suit on the bond given under the Heard Act. The provisions of this Act were invoked to sustain the claim of plaintiff. The basis of the decision is thus stated, "The rights and liabilities of the parties to a bond given to the United States under the Federal Statute rest upon the federal law and not the State law." The dissimilarity of the facts of both cases to the one under review is apparent.

Another reason for granting the petition is thus stated:

> "The Court below has decided an important question of federal law not settled by your Honorable Court and in a way probably in conflict with applicable decisions of your Honorable Court concerning rights and liabilities of parties affected by the provisions of the Hurd Act, supra, Martin v. National Surety Co., 300 U. S. 588 (1937); Morley Construction Co. v. Maryland Casualty Co., 300 U. S. 185 (1937); Walker v. Brown, 165 U. S. 654 (1897); Prarie State Bank v. United States, 164 U. S. 227 (1896); Henningsen v. United States Fidelity & Guaranty Co., 208 U. S. 404 (1908)." (p. 10 of petitioner's brief.)

In none of the cases cited were the questions raised similar to the one under discussion. The first of these cases was *Martin v. National Surety Co.* In that case the question of the applicability of the doctrine of *Erie v. Tompkins, supra,* was not involved. The decision was based squarely on the validity of an equitable assignment of the proceeds of a government contract as against a person who had full knowledge of the assignment. Reference has been made to this decision both by Judge Forman and the Circuit Court of Appeals upon another point that was raised below, but is not now under review. (R. 132, 133, 159, footnote 5)

In *Morley Co. v. Maryland Casualty Co.*, 300 U. S. 185, the question involved was the form of relief in a litigation between the contractor and the Surety Company, upon a supplementary agreement. There was no question decided in that case even closely resembling the facts in the pending controversy. The issue involved the relation of the contractor and the surety under the supplementary agreement. Not only was there no reference in that case to the doctrine of *Erie v. Tompkins*, but the question upon which the decision rested related to the form of relief that should have been granted.

I cannot understand the reason for citing *Walker v. Brown*, 165 U. S. 654, as an authority. In this case the applicability of the rule in *Erie v. Tompkins, supra*, was not involved. Among the statements of the Court in this case is this one:

> "It is well settled, said the Court in Pinch v. Anthony, 8 Allen, 536, 'that a party may by express agreement create a charge or claim in the nature of a lien on real as well as on personal property, of which he is the owner or in possession, and that equity will establish and enforce such charge or claim, not only against the party who stipulated to give it, but also against third persons, who are either volunteers, or who take the estate on which the lien is agreed to be given with notice of the stipulation."

It may be readily seen from the above quotation that such decision has no application to the present case.

The fourth case, *Prairie State Bank v. United States*, 164 U. S. 227, was also another case based upon the contractor's bond, in which the United States was a party.

The fifth and last case cited upon this point is, *Henningsen v. United States Fidelity & Guaranty Co.*, 208 U. S. 404. The grounds of suit and relief were based on the

statutes of the United States and those statutes entered as elements into the decision of the Circuit Court of Appeals and were necessary elements. It was an action in which the fund was in court and the rights of the rival claimants determined.

Respecting these last cited cases, Judge Goodrich, for the Circuit Court of Appeals said:

> "Whatever the rights and liabilities of the parties might be if they were measured solely by a bond given under the Heard Act and transaction arising thereunder, here they have made a subsequent agreement which we find to be governed by New Jersey law." (R. 161)

The contention in this section of the brief as to the effect of the legislation upon the Grover case has already been discussed and answered. (See Brief, pp. 13 and 14.)

VI. THE PETITIONER HAS NOT SHOWN SUFFICIENT REASONS ENTITLING IT TO A WRIT OF CERTIORARI.

The present controversy does not involve any new questions. The line of demarcation between cases in which federal and state laws are to be applied has been clearly established. When the relief sought is confined to the ascertainment of the rights and liabilities arising out of an agreement between two citizens, and jurisdiction is based solely on diversity of citizenship, the law is well settled. In no instance has there been any departure from the court's policy in this respect. To such an extent has this court adhered to the doctrine of *Erie v. Tompkins* that it will not disturb the ruling of the lower federal courts applying local law except upon a plain showing of error.

Palmer v. Hoffman, U. S. Supreme Court, decided October Term 1942.

There was no principle involved nor issue presented which this Court should review.

VII. CONCLUSION.

This petition for the writ should be denied.

Respectfully submitted,

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